



**BEFORE THE CALIFORNIA PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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Order Instituting Rulemaking into the Review of
The California High Cost Fund B Program.

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R.06-06-028

**APPLICATION OF THE UTILITY REFORM NETWORK
FOR REHEARING OF D.07-09-020**

October 9, 2007

Christine Mailloux
Telecommunications Attorney
The Utility Reform Network
711 Van Ness Ave., Suite 350
San Francisco, CA 94102
Ph. (415) 929-8876, ext. 353
Fax (415) 929-1132
cmailloux@turn.org

I. INTRODUCTION

Pursuant to Public Utilities Code §1731 and Rule 16.1 of the Commission's Rules of Practice and Procedure, The Utility Reform Network files this Application for Rehearing of D.07-09-020 ("Final Decision"). The Final Decision applies a newly created "affordability standard." This concept purportedly determines a single dollar figure for telephone service that all consumers in California can afford. The Commission has determined that for California consumers the affordability standard is \$36 per month. The Commission's adoption of a \$36 affordability standard is not supported by the record, is in factual error, and violates universal service statutes and standards by allowing substantial and unjustified rate increases for basic telephone service in rural areas of this state. The Commission must delay the adoption of a specific dollar figure until a record on affordability can be built to support the findings. Pursuant to Public Utilities Code §1757.1, a Final Decision adopted in a quasi-legislative proceeding is subject to further review under specific circumstances, two of which are present here. The Final Decision, D.07-09-020, is not supported by the findings and the Commission fails to proceed in a manner required by law.

II. THE FINDINGS DO NOT SUPPORT THE ADOPTION OF AN AFFORDABILITY STANDARD

In the initial application of the California High Cost Fund-B ("CHCF-B" or "the Fund"), one of the elements used to administer the Fund was the use of a cost benchmark. The Commission used this benchmark to determine the amount of the subsidy that each carrier receives from the Fund for a specific geographic serving area. This cost

benchmark set the level at which a geographic serving area was considered “high cost” and determined the amount of the subsidy that each carrier received from the Fund.

In the Final Decision the Commission changes the focus of the benchmark away from cost and toward consumer expenditure, looking specifically at affordability and reasonable comparability of rates between urban and rural areas.¹ The Commission bases its application of this new approach to benchmarking solely on nationwide surveys of consumer expenditures on telecommunications services. As a result, the Commission revises the cost benchmark for the Fund up to \$36 from the existing level of \$20.30.²

However, the Commission goes too far when it transforms the cost benchmark used to size the Fund into an “affordability standard” for purposes of setting rate caps for basic service in high cost areas.³ There are only two findings of fact in the Final Decision that relate in any way to the adoption of a specific \$36 figure for the affordability standard.⁴ These findings are broad general statements that do not support the subsequent ordering paragraphs. Finding of Fact 12 cites to a single statistic that spending for wireline service has remained steady over the course of five years. Finding of Fact 13 makes a bold conclusion that \$36 is a “reasonable proxy of customer affordability” and claims to base that proxy on “relevant demographic data.” But, as discussed below, the single statistic in FOF 12 is not relevant to the affordability of basic service and there is no “relevant demographic data” in the record.

Indeed, the only things close to the “relevant” demographic data referred to by the Commission are three surveys placed in the record by Sprint and Time Warner. These

¹ Final Decision at p. 5, 41.

² *Id.*

³ Final Decision at Ordering Paragraph 7.

⁴ The other relevant Findings of Fact, FOF 9-11, set forth principles for creating a benchmark, but do not support the adoption of a \$36 figure as the affordability standard.

surveys consist of nationwide data on rates and consumer expenditures on telecommunications services generally. Not only does the Commission misinterpret these surveys and use the wrong number to represent consumer spending on basic local exchange service, but more importantly, these nationwide surveys are completely inadequate as support for the adoption of any affordability standard for California consumers. An affordability standard of \$36 is not supported by the findings and, consequently the Commission fails to proceed in a manner required by law when it adopted D.07-09-020.⁵ These errors of law make the Final Decision ripe for review under Public Utilities Code §1757.1(a)(4), (2).

A. The Cited Surveys Cannot Support an Affordability Standard

There is no analysis in the record on the affordability of telephone service, a determination that would require particular data that simply was not presented, much less analyzed. The surveys relied upon by the Commission do not begin to support such a broad and sweeping conclusion that California consumers, particularly those in rural areas supported by the Fund, can afford a \$36 basic service rate. For example, the Commission cites to the fact that AT&T has the lowest rate for residential exchange service compared to other cities in the United States.⁶ While that may be a true fact, it is irrelevant to whether California consumers can afford a \$36 basic service rate, a figure that is more than double AT&T's current rates. Indeed, \$36 is over \$10 more than the highest rate in California cited by that survey and still higher than the rates in the most expensive cities in Tennessee, Arkansas and Wisconsin.⁷ It is inconceivable that the

⁵ Public Utilities Code §1757.1.

⁶ Final Decision at pp. 43-44.

⁷ Final Decision at p. 44.

Commission would use this survey as support to claim a \$36 rate affordable for California consumers when that rate would be one of the *highest rate in the country*. Additionally, a nationwide comparison of rates is only tangentially relevant data as to whether those rates are affordable. The analysis of affordability of basic service in California must, at a minimum, evaluate rates for basic service in California in light of California incomes and expense levels in California. Reliance on a national rate survey alone is inadequate to support the Final Decision.

The other surveys, introduced by Sprint, look at household expenditures on all telecommunications services, including wireless. Even if these surveys did not suffer from only having nationwide averages that have little to do with California's rural population, they do not separately identify basic residential phone service and for that reason are irrelevant to the affordability of basic residential phone service. Sprint provided data demonstrating the increased consumer expenditures on wireless service to attempt to prove the point that consumers are "willing" to spend more on telecommunications services generally.⁸ Sprint makes a leap (and error) of logic, which the Commission wholly adopts, that the figures for consumer spending on all telecommunications is evidence of affordability for basic service alone. The surveys Sprint cites make no analysis of stand alone basic service rates in California, much less whether those rates are affordable.

An analogy may be helpful here. If some home owners are installing swimming pools, no one would contend that the cost of swimming pools should be factored into a determination of housing affordability for purposes of basic housing needs. Yet this is

⁸ Comments of Spring Nextel in Response to the Assigned Commissioner's and Administrative Law Judge's Ruling Soliciting Further Comments, April 27, 2007 at p. 11-12.

the logic underlying the Commission’s decision – because some consumers are spending more on services that go beyond “basic residential phone service,” the argument goes that it may safely be assumed that all consumers can afford to spend more on the basic service. While the \$36 figure may accurately represent expenditures on multiple wireline services, that figure is irrelevant to the more limited determination for “basic residential phone service” here. The Commission erred in relying on the surveys.

Although the Commission bases its affordability standard on two nationwide surveys, in other parts of the Final Decision the Commission rejects proposals precisely because those proposals rely on nationwide numbers. For example, the Commission rejects Verizon’s proposal to use an FCC safe harbor rate as the basis for the benchmark:

We decline to adopt the use of the FCC “safe harbor” rate as a basis for revising or indexing the B-Fund benchmark. While we find merit in such an approach, the B-Fund benchmark is intended to provide a demarcation of “high cost” regions eligible for B-Fund subsidies based upon affordability of *California specific costs*. By contrast, the FCC “safe harbor” rate is based upon *nationwide revenues* and other charges (such as 911 fees and sales taxes). Even though SureWest offered certain refinements to the FCC “safe harbor” rate to reflect more California-specific data, we still find the resulting figures are inappropriate as a basis to set a high cost threshold for B-Fund purposes.⁹ (emphasis in the original)

Despite this statement on page 43, just two pages later the Commission adopts a \$36 affordability standard based solely on nationwide numbers. Nowhere does the Commission explain or justify its conflicting rationale. When adopting the affordability standard, the Commission made no attempt to adjust the numbers for California or to take into account California-specific factors, despite support from

⁹ Final Decision at p. 43.

SureWest and others in the record to do so.¹⁰ Instead, the only attempt at rationalization is the unsupported assertion that there “is no reason to conclude that California customers’ expenditure patterns differ significantly from this [national] average figure.”¹¹

B. The Commission Failed to Perform a Proper Analysis of Affordability

There are many factors that must be analyzed for evidence of affordability. The Commission’s reliance on nationwide consumer expenditure is unduly limited. Even if the cited surveys had been California-specific, the record still would not have been sufficient to support the Commission’s determination of affordability. The amount an average customer pays today for bundled telephone service is not relevant to, much less determinative of, whether one of those services, basic local exchange, is affordable in high cost areas. The Commission made no attempt to look specifically at the situation of consumers in high cost and rural areas, nor to segment California consumers into like-situated groups to determine the impact of a rate change on various demographic groups.

Given the truncated time provided for Comments, TURN was only able to provide preliminary and limited California-specific data. Even so, this data highlighted the fact that California consumers have to deal with higher cost of living, higher inflation rates, and higher housing costs than the national average.¹² TURN does not suggest that the data presented in our comments would suffice as a record that might support findings on affordability of basic service in California. Instead, TURN’s comments served to

¹⁰ See, p. 42 and rejection of SureWest’s attempt to adjust the FCC safe harbor figures to reflect California-specific numbers; See also TURN Comments, April 27, 2007 at p. 5, 14; SureWest Comments, April 27, 2007 at p. 3, 11; DRA Comments, April 27, 2007 at p. 32.

¹¹ Final Decision at p. 48.

¹² Comments of the Utility Reform Network, April 27, 2007, at p. 6.

provide examples of the types of data the Commission needs to gather in order to correctly determine an affordability standard and demonstrated the inapplicability of national data. The Commission erred when it ignored TURN's comments in favor of nationwide data that merely demonstrates how much consumers on a national basis *spend* on average for all wireline telecommunications services (local, long distance, and vertical features), not what they can *afford* for basic service. There is no justification to support the determination of affordability of basic service to California consumers by relying only on survey data of the amount spent nationwide on a different set of services. The omission is fatal to the outcome the Final Decision adopts on this point. The record is wholly insufficient and the adopted affordability standard must be overturned.

C. The Adopted Affordability Standard is Technically Incorrect

Even if the Commission had a record to support the adoption of a specific number for the affordability standard for basic service, a \$36 figure is incorrect. There are no findings in the Final Decision that support this adopted number; but had there been, those findings would have been in error.

In the Proposed Decision the Commission puts forth the \$36 figure as “representing average household expenditures on basic service.”¹³ No fewer than three parties pointed out the error in the Proposed Decision on this point.¹⁴ As discussed above, that figure actually represents monthly expenditures on much more than basic service. Because this figure represents more than basic service -- including toll, bundled services, customer calling features, etc. -- this figure is a far cry from the “conservative”

¹³ Proposed Decision at p. 44.

¹⁴ TURN Opening Comments on PD, August 23, 2007, at p.8; AT&T Opening Comments on PD, August 23, 2007 at p. 14; DRA Opening Comments on PD, August 23, 2007 at p. 5.

proxy for affordable basic service alone the Commission purports to be adopting in the Final Decision.¹⁵

The Commission acknowledges the parties' comments and the initial error by stating in a paragraph that appears in the Final Decision for the first time, "We recognize that the \$36 benchmark figure incorporates a broader range of local exchange and toll services and is not limited only to basic service."¹⁶ Unfortunately, despite acknowledging the mistake, the Commission makes no effort to correct it or to justify the continued use of the admittedly wrong number. Indeed, the blatantly erroneous statement that the \$36 represents basic service expenditures is still in the Final Decision (at p. 45). The Commission seems to imply that this figure only includes basic service expenditures in other places in the Final Decision as well.¹⁷ Even where it acknowledges the figure encompasses more than basic service it fails to provide a justification for its continued use of the figure as the price cap for basic service alone.¹⁸ The text of the Final Decision must be corrected and, if there is a supportable rationale for continued use of a number that represents more than basic service, then one must be added. If there is no justification supported by the record, then the issue must become part of the scope of Phase II and the \$36 figure must be overturned.

D. The Commission Should Use Phase II To Determine an Affordability Standard For Basic Local Exchange Service

¹⁵ Final Decision at p. 46.

¹⁶ *Id.*

¹⁷ See p. 45, "The FCC and Census Bureau data sources reveal that the national average household expense for wireline local exchange service remained at about \$36 per month between 2000 and 2005."

¹⁸ See p. 48 where the Commission acknowledges the \$36 figure references the range of local exchange and toll services that residential customers typically purchase, but then states the figure represents a reasonable approximation of a customer's average expenditure on local exchange service alone.

As discussed above, the Commission does not have a record to support its adoption of the \$36 figure for the price cap on residential basic service rates. For other issues where there is insufficient evidence to move forward, such as the creation of the Advanced Services Fund, the Commission defers the issues to Phase II. Here, though, the agency insists on adopting a substantive outcome in Phase I and, as a result, makes both legal and technical errors when it adopts a specific rate. The Final Decision does not contemplate an opportunity for parties to advocate for a change in the standard or to provide additional evidence on affordability. Phase II may result in a change in the cost benchmark based on revised cost data, but the Final Decision does not explicitly suggest a change in the cost benchmark will also result in a change in the affordability standard. In its comments on the Proposed Decision, TURN argued that it was inappropriate to adopt an affordability standard prior to taking evidence about affordability in California, and proposed that if the Commission insisted on moving forward to adopt an affordability standard at this juncture it should use the national averages for spending on stand-alone basic service as an interim measure only until better data on affordability can be put into the record.¹⁹ Unless this Final Decision is amended, there is no opportunity to revisit the the affordability standard despite the lack of evidence supporting its adoption.

III. THE COMMISSION’S INTENT IN ADOPTING AN AFFORDABILITY STANDARD IS NOT CLEAR

A. The Final Decision Allows For Significant Rate Increases

¹⁹ Comments of the Utility Reform Network, August 27, 2008, at p. 11.

The Final Decision adopts the \$36 figure as a reasonable benchmark and declares that same number as “a conservative proxy of basic service costs that a consumer may reasonably afford.”²⁰ The Final Decision is very clear that the \$36 will be implemented as the new benchmark starting January 1, 2008 with the final adjustment up to \$36 to be in effect on July 1, 2009. However, the Commission’s intent as to the affordability standard is not at all clear. The Final Decision states,

The \$36 benchmark, however, is in no way intended to serve as a cap on basic rate levels, or as a determination that retail rates for basic service alone as high as \$36 would be affordable. Likewise, this benchmark level does not indicate that we believe it is appropriate for basic service to rise to a level of \$36.²¹

However, Ordering Paragraph 7 states,

On [January 1, 2008 and January 1, 2009], the basic rate freeze shall be lifted on all remaining basic residential lines, but subsequent increases in ILEC basic rates shall be phased in under a process to be determined in Phase II of this proceeding in order to bring basic rate caps up to the level of the revised benchmark threshold of \$36 per line.

The Commission cannot have it both ways. In response to comments on the Proposed Decision (and a potential public and political backlash), the Commission attempts to soften its \$36 affordability standard with the statement that it “would not be appropriate” for rates to rise to \$36. However, the Commission does nothing to prevent rates rising to that level and, in fact, in several places suggests basic service rates at \$36 per line or more would be reasonable. For example, the Final Decision states that “it is thus reasonable to rely on the \$36 figure as a basis for benchmarking the level of expenditures that can be considered affordable, consistent with our universal goal of a 95% penetration

²⁰ Final Decision at p. 45.

²¹ Final Decision at p. 46.

rate.”²² It explicitly anticipates price increases in basic exchange services and sets a transition period to “avoid the risk of sudden large rate increases.”²³ The Commission also appears to set the ultimate objective of cost-based rates in high-cost areas. “While we recognize the need to start the process to enable basic rates to move closer to costs, we also share the concerns of certain parties as to the potential for retail rate shock if full pricing flexibility for basic rates were granted immediately. We believe that cost based rates for basic service should be implemented gradually. . . toward the goal of cost-based rates, as disciplined by competitive market forces.”²⁴ In its Opening Comments on the Proposed Decision, TURN noted that according to currently available data there are about 263,000 households in AT&T and Verizon service areas where the FCC’s model indicates that costs are above \$36 per month, with over 120,000 households located in areas where costs exceed \$50 per month.²⁵ The Commission has made a very clear statement to carriers, who will soon be given full pricing flexibility for basic service, that \$36 is a reasonable and affordable price for California consumers even in rural areas. The Final Decision seems to clearly contemplate a rate increase in basic service rates to the new and “reasonable” price cap of \$36, despite conflicting statements to the contrary in the text of the Final Decision. These conflicting statements create a Final Decision that is not supported by the findings and is unlawful.

²² Final Decision at p. 48.

²³ See p. 50, “transition to full rate flexibility can be implemented in a manner that avoids the risk of sudden large rate increases.”; See also, p.44 footnote 75 “after the rate freeze expires, AT&T will have the flexibility to raise its basic residential rate to cover costs.”

²⁴ Final Decision at p. 93.

²⁵ TURN Opening Comments on the Proposed Decision, August 27, 2007 at p. 15.

B. The Final Decision Violates Universal Service Statutes and Principles by Allowing For Significant Rate Increases

The adoption of a \$36 affordability standard, with no long-term mechanism in place to guard against rate increases up to and possibly beyond \$36 a month for basic service is a violation of Legislative mandates regarding universal service and just and reasonable rates. Thus, the Commission has not proceeded in a manner required by law making this Final Decision reviewable pursuant to Public Utilities Code §1757.1(a)(2).

The Commission recognizes its obligations to ensure rates in rural areas remain “just and reasonable.”²⁶ Inexplicably, the Commission then allows for substantial price increases in basic telephone rates in rural areas over the next few years, as discussed above, suggesting that a phase-in of those increases to avoid rate shock is all that is needed to be done to meet its obligations under the statute. The Commission has not done a proper study of affordability and thus cannot demonstrate that a \$36 rate, or a rate possibly higher than that based on cost, is just and reasonable. This is a violation of Pub. Util. Code §451 and must be overturned.

The Commission also acknowledges the strong public policy that state and federal lawmakers have adopted to ensure universal service.²⁷ Even in a competitive environment, the Legislature mandates that the Commission’s policies support universal service.²⁸ Thus the Commission’s emphasis on allowing competitive market forces to determine the appropriate pricing of basic services is misplaced.²⁹ The Commission’s logic runs counter to the underlying rationale for universal service programs, i.e., that

²⁶ Final Decision at p. 8, “[a transition process will], ensure just, reasonable and affordable rates, as required by Pub. Util. Code §451.”

²⁷ Final Decision at p. 17 citing to Public Utilities Code §§ 709(a), 709.5(a), 739.3; 47 U.S.C. §§253(b), 254(b)(3), 254(f) .

²⁸ Public Utilities Code §709(a).

²⁹ Final Decision at p. 8.

consumers, left to respond to unhindered market forces will not consume the economically efficient level of telephone service. Telephone services are subject to a *network effect*, i.e., the value of the network increases as more consumers subscribe to telephone services. Consumers do not take this “external” effect into consideration when making purchase decisions, thus unless policy measures are implemented to offset this market failure, a less than economically optimal network results. If prices are aligned with “actual costs” in high-cost areas, prices will rise dramatically, and fewer consumers will subscribe to telephone services.

Thus, the dilemma facing residential consumers in high-cost areas regarding rates for telephone service does not end at \$36 per month. Basic economic theory tells us that rising prices will result in lower levels of consumption. The result, due to rising prices and the existence of network effects, will be an economically inefficient outcome—in other words, the Final Decision undermines statutory objectives with regard to the promotion of universal service in high-cost areas of the state. The Final Decision proposes that rates in high cost areas should rise dramatically, thus undermining the critical affordability component of the Commission’s implementation of universal service principles. In this manner the Commission has not proceeded in a manner required by law when it set the rate caps for basic service at \$36 per month in blatant disregard for universal policies.

IV. CONCLUSION

For the reasons stated above, the Final Decision D.07-09-020 in the above referenced docket is not supported by the findings. Specifically, the Commission’s adoption of a \$36 affordability standard is not based on proper record evidence and has

insufficient findings of fact to support its implementation. Further, the Commission has not acted in a manner required by law when it adopted D.07-09-020 because the affordability standard of \$36 is in violation of the Commission's legislative mandates to ensure rates are just and reasonable and to ensure its policies are consistent with universal service principles. As a result, the Commission must review this decision pursuant to Public Utilities Code §1757.1 and overturn the adoption of a \$36 affordability standard. The Commission can take additional evidence on affordability in future phases of this proceeding and set a proper standard at that time.

Dated: October 9, 2007

Respectfully submitted,

/S/

Christine Mailloux

Telecommunications Attorney
The Utility Reform Network
711 Van Ness Ave., Suite 350
San Francisco, CA 94102
Ph. (415) 929-8876, ext. 353
Fax (415) 929-1132
cmailloux@turn.org

CERTIFICATE OF SERVICE

I, Larry Wong, certify under penalty of perjury under the laws of the State of California that the following is true and correct:

On October 9, 2007 I served the attached:

**APPLICATION OF THE UTILITY REFORM NETWORK
FOR REHEARING OF D.07-09-020**

on all eligible parties on the attached lists to **R.06-06-028**, by sending said document by electronic mail to each of the parties via electronic mail, as reflected on the attached Service List.

Executed this October 9, 2007, at San Francisco, California.

/S/

Larry Wong

Service List for R.06-06-028

astevens@czn.com	dgw@cpuc.ca.gov
beth.fujimoto@cingular.com	gtd@cpuc.ca.gov
bnusbaum@turn.org	jjs@cpuc.ca.gov
cborn@czn.com	kar@cpuc.ca.gov
cindy.manheim@cingular.com	lah@cpuc.ca.gov
cmailloux@turn.org	ma1@cpuc.ca.gov
david.discher@att.com	mhm@cpuc.ca.gov
deyoung@caltel.org	ncl@cpuc.ca.gov
don.eachus@verizon.com	ndw@cpuc.ca.gov
douglas.garrett@cox.com	nxb@cpuc.ca.gov
elaine.duncan@verizon.com	psp@cpuc.ca.gov
ens@loens.com	rkk@cpuc.ca.gov
esther.northrup@cox.com	rwc@cpuc.ca.gov
jacque.lopez@verizon.com	rwh@cpuc.ca.gov
jclark@gmssr.com	trp@cpuc.ca.gov
jesus.g.roman@verizon.com	
joe.chicoine@frontiercorp.com	
jwiedman@goodinmacbride.com	
katienelson@dwt.com	
kevin.saville@frontiercorp.com	
Kristin.L.Jacobson@sprint.com	
ll@calcable.org	
lmb@wblaw.net	
marcel@turn.org	
mcf@calcomwebsite.com	
michael.foreman@att.com	
mmattes@nossaman.com	
mp@calcable.org	
mschreiber@cwclaw.com	
mshames@ucan.org	
mtobias@mlawgroup.com	
pcasciato@sbcglobal.net	
peter.hayes@att.com	
PHILILLINI@aol.com	
prosvall@cwclaw.com	
pucservice@dralegal.org	
randy.chinn@sen.ca.gov	
rcosta@turn.org	
rudy.reyes@verizon.com	
scratty@adelphia.net	
Stephen.h.Kukta@sprint.com	
suzannetoller@dwt.com	
thomas.selhorst@att.com	
tlmurray@earthlink.net	
tregtremont@dwt.com	